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Department of the Interior
Minerals Management Service
Attention: Rules Processing Team
381 Elden Street, Mail Stop 4024
Herndon, Virginia 20170-4817

Re: Increasing Base Rentals and Sliding Scale Rentals, 70 Fed. Reg. 10,111 (March 2, 2005)

Dear Sir or Madam:

Chevron U.S.A. Inc. (Chevron) appreciates the opportunity to comment on the Minerals Management Service's (MMS) Federal Register notice proposing to increase base level rentals for all newly issued leases in the Gulf of Mexico (GOM) and to implement a sliding scale component for rentals on leases located in deepwater. Chevron is engaged in all aspects of the offshore oil and natural gas industry and is an owner of hundreds of leases found in the federal waters of the GOM. As a major lessee of both producing and non-producing leases in the GOM Chevron has a keen interest in MMS's proposal to increase the base rentals for newly issued leases.

Proposed Rental Changes for Leases in Water Depths of 200 Meters or Less

Chevron would prefer that rental rates remain the same, but understands that adjusting for inflation and to compensate for changes in the economy are reasonable justifications for raising rentals offshore, particularly for leases in waters less than 200 meters in depth where MMS is proposing to increase rentals from $5.00 to $6.25. Rentals for leases in these shallow waters have not been adjusted for over a decade. Even though the proposed rental rate equates to a 25% increase over existing rates, Chevron believes that the proposed new rental rate is not excessive and will not have an adverse impact on future leasing activity in shallow water.

Proposed Rental Changes for Leases in Water Depths Greater Than 200 Meters

In regard to deepwater leases, MMS proposes an increase in base rentals, on a non-escalating basis, from $7.50 to $9.50 per acre. This is a 26.67% increase. When the sliding scale component is added to the proposed lease rental rate increase on deepwater leases not drilled during their primary term, the actual rental increase exceeds 55%. Thus, the cost of holding an un-drilled GOM deepwater lease after acquisition for 10 years under MMS's proposal would be $672,480.00, compared to the $432,000.00 a lessee pays under existing leases. This is an increase of $240,480.00 per lease.

In Chevron's view the sliding scale component of MMS' proposal covering deepwater leases is excessive and will have a detrimental effect on deepwater leasing in the future. In deepwater as on the shelf, lessees attempt to purchase leases in geographic areas believed to contain the greatest potential for significant hydrocarbon accumulations. In frontier areas, especially where well control and other data are limited, some lessees attempt to purchase not only targeted geological prospects but leases on trend with the targeted opportunities. This trend leasing strategy allows lessees the ability to capture additional drilling opportunities should initial exploration drilling prove successful. This trend philosophy helps mitigate the significant risks lessees assume by exploring in frontier areas. If the deepwater rental rates are increased as proposed by MMS, lessees will experience a substantial increase in the costs of maintaining their non-producing lease inventory compared to current lease inventory levels. The economics of trend leasing will change with implementation of a sliding scale component on deepwater rentals. Chevron believes the rental increases proposed for deepwater could have a negative impact on the number of deepwater blocks receiving bids and cause fewer leases to be issued.

Further, MMS states that part of the justification for suggesting a sliding scale component for deepwater leases is to "encourage exploration drilling in deepwater areas earlier in the lease term . . . ." 70 Fed. Reg. at 10,111. MMS should recognize, however, that lessees generally take longer to explore deepwater leases than shallow water leases due to the increased costs, substantial uncertainty in the resource base, and limited geological, geophysical and well data. Chevron does not believe that stepped up rental costs in the later years of the primary lease term for deepwater leases will have the effect of encouraging lessees to drill sooner. Lessees already have a direct economic incentive to drill and develop the best opportunities in their lease inventory as early as is practically possible and there is no need to penalize them in the later years of a leases' primary term for failing to drill early. It takes considerable time and effort to properly evaluate a deepwater lease. A ten year primary term with fixed, not escalating, rentals is appropriate given the time, expense, work, and risk involved in exploring deepwater areas.

Conclusion

As stated earlier, adjusting rentals to compensate for changes in inflation is reasonable. However, implementing the sliding scale rental rate for deepwater leases unfairly and unnecessarily penalizes those companies which risk significant capital to explore frontier deepwater areas. Chevron recommends MMS consider leaving the offshore lease rentals at their current amounts, but, if an increase in rentals is believed justified, adjusting rental rates for shallow (less than 200 meters) and deepwater leases (greater than 200 meters) at a fixed amount is preferable to implementing any escalating component for rentals.

We again wish to express our appreciation at being given the opportunity to comment on the proposed change in rental rates. Should there be any questions regarding our comments, please do not hesitate to contact me.

Yours truly,